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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 000257

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SUBJECT: JAPANESE AND IRAQIS FINALLY EXECUTE FIRST LOAN DOCUMENTS

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Classified By: Ambassador J. Thomas Schieffer for reasons 1.4(b) and (d)
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11. (C) SUMMARY: Japanese and Iraqi officials signed loan agreements worth over USD 1.5 billion covering eight reconstruction projects in Iraq. These are the first of Japan's USD 3.5 billion worth of soft yen loans to Iraq to be signed and come after an extended period due to Iraq's lack of capacity to approve such loans. Domestic political concerns in Iraq also played a role in slowing approval. Administering these loans will pose new challenges for the Japanese and the Iraqis, unlike those encountered in disbursing an earlier USD 1.5 billion in grant aid. END SUMMARY.

LOAN AGREEMENTS SIGNED

12. (U) The loan agreements were signed January 25, 2008, in Tokyo by Iraqi Ambassador Ghanim Al-Jumaily and Japan Bank for International Cooperation (JBIC) President Koji Tanami, according to JBIC Director for Middle East Operations Hideki Matsunaga. As discussed in reftel, the contracts cover eight projects worth over USD 1.5 billion. The eight were included in a group of ten proposals that were initially agreed upon in early 2007. They are:

- USD 272 M, Electricity Sector Reconstruction Project, Central and Southern Region;
- USD 306 M, Al-Mussaib Thermal Power Plant Rehabilitation Project;
- USD 17 M, Engineering Services for Basrah Refinery Upgrade Project;
- USD 417 M, Crude Oil Export Facility Reconstruction Project;
- USD 151 M, Khor al-Zubair Fertilizer Plant Upgrade Project, Basrah;
- USD 252 M, Port Sector Rehabilitation Project, Umm Qasr Port;
- USD 28 M, Samawah Bridges and Roads Construction Project;
- USD 79 M, Irrigation Sector Loan.

The two projects that have yet to be finally approved are an electricity sector reconstruction project in the Kurdish regions worth approximately USD 123 million, and a Basrah water supply improvement project worth approximately USD 358 million.

PROCEDURAL DELAYS

¶3. (C) Matsunaga explained to Embassy Tokyo AID Counselor and Political Officer some of the reasons it took so long to finalize these agreements. His comments mirrored closely reftel's detailed analysis of the long path these loans took to reach approval. Procedurally, the Iraqi Ministry of Finance lacked the capacity to quickly move these agreements to conclusion. According to Matsunaga, there is only one reliable Director General in the Ministry, Azez Hassan Jaffar, who can work with outside donors. The others, lamented Matsunaga, have either been sidelined, arrested or assassinated. As it was, it took 21 months to get the necessary papers moved through the Iraqi bureaucracy. Matsunaga is hopeful Jaffar will be able to help process future agreements more quickly, but also said that Minister of Finance Bayan Jabr has ultimate say in how quickly such agreements are moved.

POLITICAL OBSTACLES

¶4. (C) Domestic Iraqi political issues also played a role in slowing the process, explained Matsunaga. Vice President

TOKYO 00000257 002 OF 002

Tariq al-Hashimi became a major obstacle to ultimate approval, due to his objection that the funds were inequitably distributed, with very little of them to be spent in Sunni areas. The Japanese responded by pointing out that the predominately Sunni areas until recently have been very dangerous, making it impossible to conduct feasibility studies. In addition, the Japanese asserted that although the projects to be financed may not be physically located in Sunni areas, they would nevertheless benefit the entire country, an argument that didn't carry much weight with many influential Sunnis. And finally, they noted that the projects considered had all been proposed by the government of Iraq. Hashimi ultimately relented, but said he hoped future projects would be considered for Sunni areas. The Kurds also expressed questions about the locations of Japanese funded projects, making it known they expect seventeen percent of all Japanese funds to be spent in their areas.

FUTURE CHALLENGES

¶5. (C) Senior Japanese officials, while clearly pleased that the loan papers have been signed, realize challenges remain. Koro Bessho, Director General of MOFA's International Cooperation Bureau, and Gotaro Ogawa, MOFA's Ambassador in Charge of Reconstruction Assistance to Iraq, both told Political Officer January 30 they are aware that this is the case. Matsunaga explained that grant funds will be spent to hire local and expatriate consultants to prepare the prequalification and tender documents for the projects just signed. While it will ultimately be up to the Iraqi ministries involved (Transportation, Water Resources, Electricity, Construction and Housing, Oil, and Industry and Minerals) to decide which contractors to hire, they must comply with JBIC's international procurement guidelines. Both Bessho and Ogawa said they hope these projects and future ones will also help develop capacity in these ministries, but they realize that currently these ministries have serious problems in this respect. In addition, auditors

will be hired to make sure the funds are spent correctly. Exercising oversight in Iraq will present a challenge JBIC has not faced before, said Matsunaga. Presently, JBIC has no Iraq office, and is serving Iraq out of Amman. Unlike their administration of grant aid funds, whereby Japanese firms simply provided material to the Iraqis, corruption, sectarian politics, and ongoing violence will make it difficult to carefully monitor how funds loaned to the Iraqis are spent. Iraqi Ambassador Jumaily echoed to Political Officer the comments made by Bessho, Ogawa, and Matsunaga, but he, like them, was upbeat that the loans have finally been signed.

SCHIEFFER